United States Court of Appeals

for the Second Circuit

APPELLANT'S REPLY BRIEF

74-1596

ORIGINAL

To be argued by Edward Labaton.

United States Court of Appeals

For the Second Circuit.

STUART D. WECHSLER, on behalf of himself and all others similarly situated,

Plaintiff-Appellant-Appellee,

against

SOUTHEASTERN PROPERTIES, INC.,

Defendant-Appellee-Appellant,

MONARCH FUNDING CORP., ANTHONY J. DEMATTEO, WILLIAM L. MANNING, JAMES HENRY, RONALD ULLENBERG, DAVID L. BOYD, H. T. BRADDOCK, GEORGE E. McGEE III and CHALMERS K. SMITH, and HENRY McCORD, FORRESTER & RICHARDSON, EDITH COOPER, and SCHNEIDER & BARATTA,

Defendants-Appellees.

ON APPEAL FROM THE UNITED STATES DISTRICT COURT FOR THE SOUTHERN DISTRICT OF NEW YORK.

PLAINTIFF-APPELLANT-APPELLEE'S REPLY BRIEF.

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THE REPORTER COMPANY, INC., New York, N. Y. 10007—212 732-6978—1974

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Preliminary Statement.

Although it is conceded by at least one of the defendants that a fee may be awarded even where a private action is based upon allegations made in a governmental action (Brief for Southeastern at 14), the defendants argue, in substance, that this action was redundant. The defendants, in support of this proposition, make several

inaccurate statements which form the basis of their conclusion:

1. Defendant Southeastern argues that plaintiff engaged in no meaningful discovery, noticed depositions which were never commenced, and never discovered or inspected Southeastern's records. (Brief for Southeastern at 6)

The fact is that plaintiff commenced discovery in an orderly fashion by serving interrogatories, which were answered, and serving notice of depositions and discovery of documents. The court had ordered documentary discovery in New York and plaintiff was actively persisting in discovery when the action became moot. Arnold I. Burns, Esq., attorney for Southeastern, in an affidavit sworn to October 10, 1972, made the following averment:

> [Southeastern's counsel] has several times asked plaintiff's attorneys to adjourn any further proceedings herein until such time as the Company has an opportunity to effect the offer of rescission. *They nonetheless insist on pressing this* [*class action*] *motion and proceeding with discovery* in a case which may soon be rendered moot . . . .

(123a) [Emphasis added.] That statement is, of course, totally inconsistent with the statements referred to above and the following statement at page 9 of the Southeastern brief:

> [Plaintiff] did nothing but sit back and await the final determination of the AG action * * *.

2. Defendant Monarch argues, as did Southeastern below, that this action was unnecessary because Southeastern in May 1972, deposited $600,000 in a special escrow account for Southeastern shareholders. (Brief for Mon-

arch at 4 and 18) Similar statements in the court below were made by Southeastern that from March 20, 1972, there was an agreement to "freeze the proceeds of the public offering." (258a)

The fact is that in October, 1972, in opposition to plaintiff's class action motion, Mr. Anthony DeMatteo, President of Southeastern and the person who, in March, 1972, said that the $600,000 would remain untouched, averred that as at September 15, 1972, the proceeds of the public offering had shrunk to approximately $300,000. (182a)

Even more significant is the affidavit of Southeastern's vice-president, William Manning, sworn to on June 16, 1972 (57a *et seq.*) in which Manning stated that Southeastern was actively engaged in general business activities far more extensive than simply meeting pre-existing commitments. The activities described in Manning's affidavit are totally inconsistent with his counsel's averment a year later that Southeastern had decided "to preserve intact as much of the fund from the public offering as possible". (248a) The Manning affidavit in no way indicated that Southeastern was dormant, was only preserving its assets or was awaiting the outcome of its negotiations with the Attorney General. On the contrary, Mr. Manning, one of two key Southeastern officers, painted a picture of an active, on-going business, buying, selling and developing properties.

> It is the business of Southeastern to *acquire*, hold, *develop* and resell commercial and residential real property in the States of Tennessee and Georgia. The only two operating employees of Southeastern, Mr. DeMatteo and I, are in constant communication with prospective buyers, contractors, and developers of land who are working on or may be interested in purchasing the real estate holdings

> of the company. For example, Southeastern is currently developing one of its properties in Rhea County, Tennessee. The development of this property, which borders on a lake, involves the construction of roads and the installation of numerous docks extending out into the water.

(61a) [Emphasis added.]

Southeastern was obviously using the public's money in these activities, since the prospectus disclosed that prior to the public offering Southeastern only had $50,760 in cash. (87a) Mr. Manning, on June 16, 1972, was not only engaged in the business of developing Southeastern properties, he was also, on behalf of Southeastern, looking for new properties to buy. Thus, at paragraph 9 of the affidavit (62a), he stated:

> The business of Southeastern also requires us to be in constant communication on a daily basis with real estate brokers throughout the southeastern part of the United States in an attempt to learn of parcels of land which have just come on the market at favorable prices. We must be able to indicate our interest and travel on a moment's notice to inspect such land and to negotiate the terms with the owner.

In this context, it is clear that plaintiff had a duty to move forward in the lawsuit. Not until September was plaintiff's counsel informed that the Attorney General was proposing a rescission of the public offering. (301a) In the meantime, plaintiff believed, and with good cause, that Southeastern had no intention of making a rescission offer* (299a-300a), that it was actively engaged in using the public's money to conduct its business, and that

*As late as November 21, 1972 the District Court rejected Southeastern's claim that the action was moot, holding that "no firm offer of rescission has been made." (195a)

unless plaintiff proceeded with this action there was a danger that Southeastern's assets, including cash derived from the public, would be dissipated.

3. Southeastern states that the plaintiff never "sought to utilize the AG's investigation or assistance in the expeditious prosecution of his claim." (Brief for Southeastern at 6)

The fact is, that plaintiff's counsel requested assistance of the Attorney General and was encouraged in the prosecution of the lawsuit by the Attorney General. (300a-301a)

4. Southeastern asserts that after the Attorney General's action was settled, plaintiff served a series of interrogatories having nothing to do with the case and when objections to interrogatories were made plaintiff "rushed to the District Court and requested that it compel Southeastern to answer the interrogatories". (Brief for Southeastern at 6-7)

Prior to the service of interrogatories, plaintiff's counsel requested by letter the answer to four simple questions. (240a) The letter was totally ignored (205a) and resulted in a set of relatively simple interrogatories designed to elicit the same information. (208a-209a) The interrogatories were not answered and a motion to compel answers to interrogatories was made on June 27, 1973. (199a-200a) The following day Southeastern objected to the interrogatories. (241a)

In summary, this action was diligently and vigorously prosecuted, as it should have been, until such time as it actually became moot. When it became moot, plaintiff's efforts were designed to assure that every member of the class receive adequate notice of the rescission offer.

The points argued by the defendants other than Southeastern are in substance incorporated within Southeastern's argument and the balance of this brief will address itself exclusively to the points made in Southeastern's answering brief.

RESPONSE TO POINT I.

It was appropriate for plaintiff to prosecute the action.

Southeastern suggests that the action was improper because the Attorney General had the responsibility to enforce his state's securities laws. None of the defendants claim that the Attorney General had any responsibility, or indeed authority, to enforce the Securities Act of 1933 or the Securities Exchange Act of 1934 and the defendants cannot seriously contend that the complaint did not state a valid claim under the federal securities laws, particularly in view of Judge Gurfein's decision. (45a-48a) Indeed, we suggest that not only was plaintiff's action a permissible action, it was the preferable action for dealing with claims under the federal securities laws. In *Hawaii v. Standard Oil Co.*, 405 U. S. 251, 266 (1972), the Supreme Court denied the State of Hawaii the right to bring an antitrust action on behalf of its citizens under the theory of *parens patriae* observing that

> Congress has given private citizens rights of action for injunctive relief and damages for antitrust violations without regard to the amount in controversy. 28 USC §§1337; 15 USC §15. Rule 23 of the Federal Rules of Civil Procedure provides for class actions that may enhance the efficacy of private actions by permitting citizens to combine

> their limited resources to achieve a more powerful litigation posture . . . .
>
> . . .
>
> *Parens patriae* actions may, in theory, be related to class actions, but the latter are definitely preferable in the antitrust area. Rule 23 provides specific rules for delineating the appropriate plaintiff-class, establishes who is bound by the action, and effectively prevents duplicative recoveries.

Here, as in the *Hawaii* case, Congress has given private citizens rights of action for damages, in this instance under the securities laws. A private action was the appropriate remedy to protect the plaintiff class. The fact that under a state statute the same class was able to obtain a similar remedy which made the action moot in no way implies that the commencement of the action was improper.

The Attorney General did not commence his action until September and prior thereto there was no way of knowing what the results of his investigation would be. Hence, this case is analogous to *Green v. Transitron Electronic Corp.*, 326 F. 2d 492 (1st Cir. 1964), in which the Court of Appeals overruled the denial of a fee to an objectant because the District Court was aware of the problem raised by the objectant before the objection was raised. The Court of Appeals in directing the fee award stated that:

> We think it unfair to counsel when, seeking to protect his client's interest and guided by facts apparent on the record, he spends time and effort to prepare and advance an argument which is ultimately adopted by the court, but then receives no

> credit therefor because the court was thinking along that line all the while.

326 F. 2d at 499.

See also, White v. Auerbach, Docket Nos. 73-2739, 73-2768 (2d Cir. July 24, 1974).

Southeastern argues that it should not be required to pay a fee because it did not benefit from the plaintiff's action. Instead, it has been permanently enjoined in the State of New York from violating Articles 23A of the General Business Law, has been compelled to return the proceeds of its public offering, and was forced to undertake the expenses of a tender offer. This argument has been disposed of by the Supreme Court in *Mills v. Electric Autolite Co.,* 396 U. S. 375, 389-90 (1970):

> [P]etitioners, who have established a violation of the securities laws by their corporation and its officials, should be reimbursed by the corporation or its survivor for the costs of establishing the violation.

RESPONSE TO POINT II.

The acceptance of the rescission offer by the named plaintiff does not bar an application for fees.

In making the rescission offer to the class, which embraced the named plaintiff, defendants included a release which the named plaintiff was compelled to sign in order to receive repayment for the share which had been fraudulently sold to him. Southeastern asserts, without citing any authority, that "it is hornbook law that Southeastern has a complete defense to plaintiff's claim for his litigation expenses." (Brief for Southeastern at 14) The ap-

plicable principle was succinctly stated in the leading article on attorneys' fees in stockholder actions:

> The courts have nullified all efforts by defendants to evade payment of the compensation which complainant or his attorney is equitably entitled to receive. Plaintiff's counsel is held entitled to compensation where the defendants settled out of court and paid directly to the corporation the moneys sued for. He is entitled to compensation from all members of the class, even though defendants secure releases from all stockholders other than the plaintiff. He is also entitled to compensation even though his immediate client, the complainant, may be "bought out" after successful suit, and pending or during the course of the accounting thereby ordered, or prior to payment of final judgment.

Hornstein, *The Counsel Fee in Stockholder's Derivative Suits,* 39 Colum. L. Rev. 784, 809 (1939) [Footnotes omitted]; *See also, Pearlstein v. Scudder & German,* 429 F. 2d 1136, 1142-43 (2d Cir. 1970), *cert. denied,* 401 U. S. 1013 (1971).

Conclusion.

The District Court's order dismissing the action should be reversed and the case remanded for a hearing on an appropriate fee for plaintiff's counsel.

Respectfully submitted,

SHATZKIN AND COOPER,
Attorneys for Plaintiff.

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